IN THE

Supreme Court of the United States

No.

J. H. SCHAEFFER, JR. AND
OPAL R. SCHAEFFER, PETITIONERS,

VS.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

JAMES F SCHAEFFER
Attorney for Petitioners

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IN THE

Supreme Court of the United States

No.....

J. H. SCHAEFFER, JR. AND
ORAL R. SCHAEFFER, PETITIONERS,

VS.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Come the petitioners and pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Sixth Circuit in the above entitled case.

"OPINIONS BELOW"

The opinion of the Tax Court is not officially reported but is a part of the certified record in this cause. The opinion of the Sixth Circuit, filed on August 20, 1958, is also a part of the Certified Record in this cause.

JURISDICTION

The jurisdiction of this Court is invoked under 28 U.S.C.A., Section 1254 generally and in particular on the following grounds:

(1) The Court of Appeals for the Sixth Circuit has rendered a decision in this case which is in conflict with the decisions of other courts of appeals on the same matter. Keasby and Mattison Company vs. U.S.A., (CA 3rd 1944) 141 F. 2d 163, Johnson vs. Commissioner (CA 4th 1956) 233 F. 2d 952, Texas Trailer Coach Co. vs. Commissioner (Ca 5th 1958) ..... F. 2d ....., Glover vs. Commissioner (CA 8th 1958) ..... F. 2d ....., Baird vs. Commissioner, (CA 7th 1958) ..... F. 2d. .....

(2) The Court of Appeals for the Sixth Circuit in this case has decided an important question of Federal Law which has not been, but should be settled by this Court.

(3) This is a tax case and is based entirely on Federal Law.

QUESTION PRESENTED

During 1952 and 1953, petitioner, J. H. Schaeffer, Jr., sold notes, secured by conditional sales contracts to finance companies. The agreed price of such notes was paid petitioner immediately, and in addition, out of the finance charge, the finance companies credited to petitioner on their books a "loss reserve" account. The petitioners did not receive and had no right to receive any amount out of such "loss reserve" accounts during the calendar years 1952 and 1953.

The issue is whether a dealer selling tangible, personal property on a deferred payment plan and using the accrual system of accounting should be required to take into income credits made by the finance companies to the "loss reserve" account at the time such credits are entered on

the finance companies' books even though not available to petitioners.

STATEMENT OF FACTS

J. H. Schaeffer, Jr., and wife, Opal R. Schaeffer, were residents and citizens of Shelby County, Tennessee, in 1952 and 1953 (29a) and still are. They filed joint Federal Income Tax Returns for such years with the District Director of Internal Revenue in Nashville, Tennessee (13a).

During 1952 and 1953 J. H. Schaeffer, Jr., through his interest in J & S Motors, sold to Memphis Bank and Trust Company and Guardian Discount Company, related corporations doing business in Memphis, Tennessee (23a), and hereinafter sometimes referred to collectively as "Finance Company," certain installment notes received from purchasers of automobiles (23a, 32a). Coincident with the purchase of such notes Finance Company credited certain amounts, determined by contract or formulae, to at least two categories of reserve accounts in the name of J. H. Schaeffer, Jr., and/or J & S Motors on Finance Company's books (41a). One set of these accounts was identified as "Loss Reserve" accounts; the others were labeled "Special Reserve or Rebate" accounts. Amounts credited to the latter accounts were payable to appellant monthly, on or about the first day of the month following. By an agreement between Appellant and Finance Company which took effect on or about October 1, 1952, Finance Company withheld payment of the credits in Appellant's "Special Reserve or Rebate" accounts as additional security for Finance Company against possible losses on notes purchased from Appellant. By agreement between Schaeffer and Finance Company "Loss Reserve" accounts of Appellant were charge-

able with any and all losses and costs incurred by Finance Company in connection with or related to notes purchased from Appellant. No amounts were payable to Appellant out of such "loss Reserve" accounts until the balance of such accounts exceed 4% of the total value of outstanding and unpaid balances on all notes purchased from Appellant; no payment was to be made out of such accounts so long as any debt owed by Appellant to Finance Company was due and unpaid (24a, 25a).

Subsequent to audits by the Internal Revenue Service of Appellants' joint returns for 1952 and 1953, adjustments were proposed increasing appellants' net income for such years, principally based upon the net increases during 1952 and 1953 in the "Loss Reserve" accounts and the "Special Rebate" accounts on the books of Finance Company. The proposed increases (after being corrected subsequently by stipulation of the parties) are as follows (26a, 27a, 28a):

	Loss Reserve	Special Rebate	Total
1952	$ 4,064.29	$ 6,614.85	$10,679.14
1953	8,481.95	28,150.48	36,632.43
	$12,546.24	$34,765.33	$47,311.57

Appellants filed a protest with the Internal Revenue, and it and the subsequent conference with the Appellate Division were concerned solely with the increased tax liability resulting from the above-mentioned increases in Appellants' reserve accounts on the books of Finance Company. Appellants' position at that time being that no part of such increases represented taxable income during such years.

Appellants subsequently filed a timely petition in the Tax Court of the United States for a redetermination of deficiencies based on net increases in Appellants' reserve accounts. In an Amended and Supplemental Petition and in the Stipulation of Facts, Appellant has admitted and accepted liability for additional tax based upon the corrected net increases in the "Special Reserve or Rebate" accounts of J. H. Schaeffer, Jr., on the books of the Finance Company (27a, 28a). Appellant continued to deny liability for additional tax based upon increases during such years in "Loss Reserve" accounts of J. H. Schaeffer, Jr., and for J & S Motors on the books of Finance Company, since Petitioners did not receive and had no right to receive any amount out of such "Loss Reserve" accounts during the calendar years 1952 and 1953."

REASONS FOR GRANTING THE WRIT

The question in this case is the same as that presented in Commissioner v. John R. Hansen and Shirley G. Hansen, Commissioner v. Burl P. Glover, and Clifton E. Baird and Violet L. Baird v. Commissioner, Nos. 380, 381 and 512, October term, 1958, in which petitions for writs of certiorari were granted.

Writs having been granted in *Hansen, Glover* and *Baird*, this Court will soon have occasion to decide the issue involved in the instant case. The Court may wish to hold this petition in abeyance pending disposition on the merits in Nos. 380, 381 and 512 or this case may be consolidated for briefing and argument with the above cases presently pending before the Court.

Respectfully submitted.

JAMES F. SCHAEFFER
Attorney for Petitioners

APPENDIX A

Internal Revenue Code of 1939:

Sec. 22. Gross Income.

(a) **General Definition.**—"Gross income" includes gains, profits, and income derived from salaries, wages or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. . . .

(26 U.S.C. 1952 ed., Sec. 22)

Sec. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year. (26 U.S.C. 1952 ed., Sec. 41.)

Sec. 42 (as amended by Sec. 114, Revenue Act of 1941, c. 412, 55 Stat. 687)

PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

(a) General Rule. The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period.

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FILE COPY

IN THE

Supreme Court of the United States

No. 907, October Term, 1958

J. H. SCHAEFFER, JR. AND
OPAL R. SCHAEFFER, PETITIONERS,

vs.

COMMISSIONER OF INTERNAL REVENUE

APPENDIX B TO PETITION FOR CERTIORARI UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT.

JAMES F SCHAEFFER
Attorney for Petitioners

IN THE

Supreme Court of the United States

APPENDIX B
OPINION OF COURT OF APPEALS FOR THE SIXTH CIRCUIT

No. 907, October Term, 1958

J. H. SCHAEFFER, JR. AND
OPAL R. SCHAEFFER, PETITIONERS,

VS.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT.

On Petition for Review of the Decision of the Tax Court of the United States

Decided August 20, 1958.

Before: Simons, Chief Judge, Miller, Circuit Judge, and Cecil, District Judge.

Miller, Circuit Judge. The petitioners filed this action in the United States Tax Court seeking a redetermination

of deficiency income tax assessments for the years 1952 and 1953, resulting from the failure on the part of the petitioners to include in gross income certain credits in their favor on the books of a finance company, which the Commissioner ruled constituted accrued taxable income. The Tax Court upheld the assessments, which ruling is now before us on petition for review.

The facts, which were for the most part stipulated, were found by the Tax Court as follows. Petitioners, who are husband and wife, are residents of Germantown, Tennessee. They filed joint Federal income tax returns for the years 1952 and 1953. J. H. Schaeffer, Jr., the husband, hereinafter referred to as "petitioner" operated a retail used automobile business as an individual proprietor during 1952 and 1953 under the trade name of J & S Motors. The books and accounts of the business were kept on an accrual basis. In the normal course of the operation of the business petitioner sold notes executed by purchasers of automobiles under conditional sale contracts, to banks and finance companies. Certain notes executed by such purchasers were sold in 1952 and 1953 by petitioner without recourse on petitioner to Memphis Bank & Trust Company and Guardian Discount Company, both of Memphis, Tennessee. These were closely related corporations in organization, operation and business practices, having the same principal place of business, and for the purposes of this opinion will be referred to collectively as the "Finance Company."

During 1952 and 1953 whenever notes, executed by purchasers of automobiles from J & S Motors and secured by conditional sales contracts on such automobiles, were purchased from J & S Motors by the Finance Company cer-

tain payments were made to J & S Motors and certain reserves were withheld and credited to two separate and distinct reserve accounts on the books of the Finance Company. These reserves were identified on such books as "Loss Reserve" accounts and "Special Reserve" or "Rebate" accounts. Whether the amounts credited by the Finance Company to the Loss Reserve accounts constitued taxable income for the years 1952 and 1953 is the question presented. Contrary to their original contention, petitioners now concede that the amounts credited to the Special Reserve or Rebate accounts constituted taxable income, and no issue is presented on the present review with respect thereto.

Under the agreement between petitioner and the Finance Company, the amounts withheld and credited to the Loss Reserve accounts were usually 2 per cent of the notes. However, the percentage withheld varied in amount with the model of the car, and a larger percentage was withheld on older models. The creation and operation of the Loss Reserve accounts is shown by the following typical transaction. J & S Motors, in selling an automobile to a customer, would first obtain from the customer a credit statement which it submitted to the Finance Company. If the purchaser's credit was satisfactory J & S Motors made out a bill of sale indicating who held the lien on the automobile and informing the purchaser where payments were to be made. The purchaser would sign a conditional sale contract and make a down payment, consisting of a trade-in or cash or both. The following is an example of such a sale made July 26, 1952.

Cash Price	$833.00
Net trade-in allowance	228.00
Cash on delivery	60.00
Total down payment	288.00
To finance	545.00
Sales Tax	6.90*
Insurance costs	100.07
Finance charges	195.53
Total time balance	840.60

Upon completion of a sale J & S Motors would take the conditional sale contract to the Finance Company and receive from it a check for the balance of the purchase price. In the sale of July 26, 1952, referred to above, the Finance Company reflected the purchase of the conditional sale contract as follows.

Notes Receivable	$840.60
Cash, payment to J & S Motors	545.00
Cash, payment of insurance premium	100.07
Loss reserve, J & S Motors	24.23
Special rebate, J & S Motors	113.33
Income	57.97
Total	840.60

The books of J & S Motors did not reflect the reserves as income. The only amount recorded as income from the sale of an automobile was the price of the car, as if cash had been paid. By agreement between petitioner and the Finance Company, the Loss Reserve accounts of petitioner were chargeable with any and all losses and costs incurred by the Finance Company in connection with or related to notes purchased from the petitioner. In addition, there

* This item was apparently not included in computing the total.

was a verbal agreement between petitioner and the Finance Company that J & S Motors would further guarantee the company against loss by repurchasing repossessed cars from it at a fair retail price.

No amounts were payable to petitioner out of such Loss Reserve accounts until the balance of such accounts exceeded 4 per cent of the total value of outstanding and unpaid balances on all notes purchased from petitioner. No payment was to be made out of such accounts as long as any debt owed by petitioner to the Finance Company was due and unpaid. During all of 1952 and 1953 amounts credited to the Loss Reserve accounts on the books of the Finance Company were held as security against losses on notes purchased from J & S Motors. The balances on Loss Reserve accounts did not at any time during 1952 or 1953 exceed 4 per cent of the outstanding value of or amount payable on notes purchased from J & S Motors by the Finance Company. During 1952 and 1953 the petitioner did not receive any of the Loss Reserves credited on the books of the Finance Company. However, if all of the purchasers of automobiles whose notes were held by the Finance Company had met their payments on time, J & S Motors was entitled to receive the entire balances in the accumulated Loss Reserve accounts.

None of the amounts added to the Loss Reserve accounts were treated or reported as income by the petitioners. The deficiency assessments herein involved resulted from the Commissioner's ruling that petitioner's net income for the years in question should be increased by the amount of the net increases during 1952 and 1953 in the Loss Reserve accounts. Such net increases were $4,064.29 and $8,481.95, respectively, with the net balance increasing from $2,268.74

on December 31, 1951, to $14,814.98 on December 31, 1953. The Commissioner did not include in taxable income all of the amounts added to the Loss Reserve accounts in a particular year, but included only the net increases in such accounts, after allowing for actual losses arising out of defaults occurring in each of the taxable years.

Since petitioner was on an accrual basis for income tax purposes, the amounts in question constituted taxable income if they accrued to the petitioner during the taxable year, even though he did not actually receive them during the year. "Keeping accounts and making returns on the accrual basis, as distinguished from the cash basis, import that it is the right to receive and not the actual receipt that determines the inclusion of the amount in gross income. When the right to receive an amount becomes fixed, the right accrues." *Spring City Foundry Co.* v. *Commissioner*, 292 U.S. 182, 184-185; *North American Oil Consolidated* v. *Burnet*, 286 U.S. 417, 423. The application of this well settled rule to cases involving factual situations similar to the present one has been the subject of considerable litigation. The petitioners' contention that the credits did not accrue as income in 1952 and 1953 finds support in *Johnson* v. *Commissioner*, 233 F. (2) 952, C.A. 4th; *Texas Trailercoach, Inc.*, v. *Commissioner*, 251 F. (2) 395, C.A. 5th; and *Glover* v. *Commissioner*, . . . F. (2) . . . , C.A. 8th, decided April 23, 1958. See also: *Commissioner* v. *Cleveland Trinidad Paving Co.*, 62 F. (2) 85, C.A. 6th; *Keasbey & Mattison Co.* v. *United States*, 141 F. (2) 163, C.A. 3rd. The Commissioner's contention is supported by numerous tax court decisions, including *Shoemaker-Nash, Inc.*, v. *Commissioner*, 41 B.T.A. 417; *Brodsky* v. *Commissioner*, 27 T.C. 216; and *Kilborn* v. *Commissioner*, 29 T.C. No. 14, decided October 24, 1957, and by *Baird* v. *Commissioner*,

. . . F. (2) . . . , C.A. 7th, decided June 20, 1958. Three of the cases relied upon by petitioners, *Johnson* v. *Commissioner*, supra, *Texas Trailercoach, Inc.*, v. *Commissioner*, supra, and *Glover* v. *Commissioner*, supra, are reversals of Tax Court decisions which also upheld the Commissioner's contention. The opinions in the cases above referred to contain a review of the authorities and a thorough discussion of the question, which it is unnecessary to repeat in this opinion. Basically, the cases sustaining the petitioners take the position that the amounts credited to the Reserve Loss accounts were payable to the petitioner only upon various conditions precedent, which were contingencies which might bar indefinitely the dealer's receipt of the payments or the right to receive any payments at all from the account, thus constituting them contingent credits, rather than accrued income. The cases supporting the Commissioner's contention express the view that the amounts credited by the Finance Company to the Reserve Loss accounts were carried by the Finance Company and recognized by it as a liability in favor of the petitioner, that petitioner's legal right to them was undisputed, and that only the time of payment was deferred. *Franklin County Distilling Co., Inc.* v. *Commissioner*, 125 F. (2) 800, C.A. 6th. The fact that the exact amount to be paid is not determined until a later year is not material. *Continental Tie & Lumber Co.* v. *United States*, 286 U.S. 290, 295.

We agree with the Commissioner that there was nothing contingent about petitioner's legal right to the amounts so credited. The only contingency which existed was how much of these amounts would not be paid to the petitioner but would be applied by the Finance Company to the payment of petitioner's legal obligations. The contingency was

in the amount of the offset, not in the amount of the accrued income. *Brown* v. *Helvering*, 291 U.S. 193, 200-201. For income tax purposes, the amount of accrued income was fixed and did not vary. Although the amount of the credit on the books of the Finance Company might be later reduced, such reduction would be the result of the Finance Company using a portion of the credit to discharge petitioner's legal obligations, which automatically offset any reduction in the credit. The payment of a legal obligation of a taxpayer is income to the taxpayer even though such income is not actually received by him. *Old Colony Trust Co.* v. *Commissioner*, 279 U.S. 716, 729; *Tressler* v. *Commissioner*, 228 F. (2) 356, 359, Note 6, C.A. 9th; *Northern Trust Co. of Chicago* v. *United States*, 193 F. (2) 127, C.A. 7th. The immediate payment of the amounts so credited was prevented only because petitioner pledged these amounts to secure other possible obligations of his own that might later arise.

The liabilities, the payment of which was secured by the Loss Reserve accounts, were contingent liabilities of the petitioner, such as *might* result from probable default on the part of the obligors in making the required payments. *Bernstein* v. *United States*, 234 F. (2) 475, 481, C.A. 5th. The tax on income received in one year can not be withheld because losses may thereafter occur in a later year or because the ultimate result of a particular transaction may be a loss instead of a profit. *Heiner* v. *Mellon*, 304 U.S. 271, 276; *Burnet* v. *Sanford & Brooks Co.*, 282 U.S. 359, 364. Such obligations can be taken as income tax deductions only in the year in which they become actual liabilities. *Brown* v. *Helvering*, supra, 291 U.S. 193, 200-201; *E. H. Sheldon & Co.* v. *Commissioner*, 214 F. (2) 655, 656, C.A. 6th; *Franklin County Distilling Co., Inc.*, v. *Commissioner*,

supra, 125 F. (2) 800, 804, C.A. 6th. When a taxpayer is on the accrual basis losses are handled separately from income even though they relate to an item of gross income which has accrued in the same year. *Spring City Foundry Co.* v. *Commissioner*, supra, 292 U.S. 182, 185. Under the ruling in *Brown* v. *Helvering*, supra, 291 U.S. 193, and *Heiner* v. *Mellon*, supra, 304 U.S. 271, 276, the Commissioner's position must be sustained.

The foregoing analysis of the question considers the transaction only as one between the petitioner and the Finance Company. Before that transaction was entered into, the petitioner concluded a prior transaction with the purchaser of the automobile which, we believe, is the controlling factor in the case. Petitioner in selling a car to a purchaser and in taking the purchaser's note and conditional sale contract acquired an asset in the nature of an account receivable, with respect to which there was no contingency whatsoever. As between petitioner and the purchaser of the automobile, the entire amount of the contract obligation accrued to the petitioner. If such account receivable became uncollectible in whole or in part, the question was one of taking a deduction under the applicable statute. *Spring City Foundry Co.* v. *Commissioner*, supra, 292 U.S. 182, 185. There was no obligation on the part of the petitioner to sell this account receivable to the Finance Company. Actually, in a number of instances the petitioner did not sell such an account receivable and the amount called for by his contract was treated by him as taxable income. We see no reason why the completed transaction with the purchaser should not be treated in the same way in other instances where the petitioner without any legal obligation on his part to do so sells the account receivable to a finance company. The income has accrued to the peti-

tioner before the transfer is made to the Finance Company, and such subsequent transfer does not change the legal effect of the prior completed transaction. *Baird* v. *Commissioner*, supra, . . : F. (2) . . . , C.A. 7th. See: *Chamberlin* v. *Commissioner*, 207 F. (2) 462, 469, C.A. 6th, cert. denied, 347 U. S. 918.

The decision of the Tax Court is affirmed.[1]

[1] Petitioners petition to rehear was overruled by the Sixth Circuit.

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No. 907

In the Supreme Court of the United States

OCTOBER TERM, 1958

H. SCHAEFFER, JR., and OPAL R. SCHAEFFER, Husband and Wife, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

J. LEE RANKIN
Solicitor General,
CHARLES K. RICE
Assistant Attorney General,
JOSEPH F. GOETTEN
CAROLYN R. JUST,
Attorneys,
Department of Justice,
Washington 25, D. C.

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CITATIONS

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In the Supreme Court of the United States

OCTOBER TERM, 1958

No. 907

J. H. SCHAEFFER, JR., and OPAL R. SCHAEFFER, Husband and Wife, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

OPINIONS BELOW

The memorandum opinion of the Tax Court (R. 100a-117a) is not reported. The opinion of the Court of Appeals is reported at 258 F. 2d 861.

JURISDICTION

The judgment of the Court of Appeals was entered on August 20, 1958. A timely petition for rehearing was denied on December 12, 1958. By order of Mr. Justice Stewart, dated March 6, 1959, the time within which to petition for a writ of certiorari was extended to

May 11, 1959. The petition for a writ of certiorari was filed on that date. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether an accrual basis taxpayer[1] who sells used automobiles on credit and discounts his customers' obligations with finance companies, realizing part of his gain in cash and part in the form of credits—the latter portion to be ultimately satisfied either by payment in cash or by offset against the taxpayer's obligations—is required to report the amount of gain so credited (as well as the gain in cash) as income for the year in which the sales and credits are made.

STATUTES INVOLVED

Sections 22(a), 41 and 42(a) of the Internal Revenue Code of 1939 are set forth in the Appendix, *infra*, pp. 6-7.

STATEMENT

The taxpayer and his wife filed joint federal income tax returns for 1952 and 1953 with the Director of Internal Revenue for the District of Tennessee. In those years, the taxpayer operated a retail used automobile business in Memphis as an individual proprietor, under the name J & S Motors. The books were kept on an accrual basis. During 1952 and 1953, purchasers of automobiles under conditional sales contracts executed notes which the taxpayer sold without recourse to Memphis Bank and Trust Company and to Guardian Discount Company. (R. 101a.)

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[1] For convenience J. H. Schaeffer, Jr. will be referred to herein as the taxpayer, although his wife, Opal R. Schaeffer, is also a petitioner inasmuch as she filed joint returns with her husband for the taxable years involved.

When the notes were sold, the finance companies withheld a portion of the proceeds, crediting the same to the taxpayer in separate and distinct accounts known as "loss reserve" and "special reserve" or "rebate" accounts. (R. 101a-102a.) An agreement between the taxpayer and Memphis executed on November 30, 1951 (R. 104a-106a), provided for the sale of such notes on a non-recourse basis, payment from the reserve account to be made to taxpayer quarterly of all amounts over 4% of the total amounts outstanding on notes purchased from the taxpayer by the company, but no payment of any amount from the reserve to be made as long as the taxpayer was indebted to the company.[2]

Both finance companies made current entries in a loss reserve account in the taxpayer's name, crediting a percentage of cash advanced on the discounted notes and debiting repossession losses. The balances in these accounts were designed to give the finance companies

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[2] A separate agreement of the same date set out the understanding with respect to the reserve as follows (R. 107a):

> On 12 month contracts we will retain 6% per annum of cash advance, plus insurance. We will set up in a loss reserve 2% of the cash advance. The remainder will be rebates. On contracts financed for a longer period of time, the same agreement will apply on a proportionate basis. In any transaction we will retain a $20.00 minimum charge. The loss reserve will be payable quarterly all over 4% of the outstandings.

As the result of a decline in the used car market, the method of discounting paper was changed and the amount allocable to the loss reserve was increased by an amended retail reserve agreement between the taxpayer and Guardian dated May 5, 1953. (Ex. 5, R. 25a, 107a-108a.) This agreement was considered as binding also on Memphis. The taxpayer had had no written agreement with Guardian prior to that agreement, but in view of the fact that Memphis and Guardian were guided by the same people, the taxpayer considered that his agreement with Memphis pertained also to Guardian. (R. 108-109a.)

a protection from losses due to the high ratio of repossessions in the used car field. In addition, there was a verbal agreement between the finance companies and the taxpayer that he would further guarantee the companies against loss by repurchasing repossessed cars at a fair retail price. The balances in the loss reserve accounts of the finance companies in 1952 and 1953 did not exceed 4% of the outstanding value of all amounts payable on notes purchased. The taxpayer did not receive any of the loss reserves credited on the books of the finance companies in those years. However, if all of the purchasers of automobiles whose notes were held by the finance companies had met their payments on time, the taxpayer would have been entitled to receive the entire balances in the accumulated loss reserve accounts. (R. 109a-110a.)

The Tax Court and Court of Appeals held that taxpayer's net income for the years in question was properly increased by the amount of the net increases[3] in the loss reserve accounts. (R. 113a-117a.)

DISCUSSION

The sole issue in this case is when an accrual basis taxpayer shall treat as income amounts credited to reserve accounts held in his name by finance companies with which he does business. As the taxpayer points out (Pet. 5), the same issue is involved in Nos. 380, 381 and 512, *Commissioner* v. *Hansen, Commissioner* v.

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[3] The Commissioner did not include in the taxpayer's taxable income all the amounts added to the loss reserve accounts in a particular year, but only the net increases in such accounts after allowing for actual losses arising out of defaults occurring in each of the taxable years. (R. 26a-28a.)

Glover, and *Baird* v. *Commissioner*,[4] now awaiting decision by this Court. The petition suggests (Pet. 5) that the Court defer action in the instant case pending disposition on the merits in the *Hansen*, *Glover* and *Baird* cases. We agree with this suggestion, having, indeed, made similar suggestions in petitions for certiorari filed in other cases involving this same issue. See Nos. 561 and 761, *United States* v. *Hine Pontiac* and *United States* v. *Colonial Chevrolet Corporation*.

Respectfully submitted,

J. LEE RANKIN,
Solicitor General.

CHARLES K. RICE,
Assistant Attorney General.

JOSEPH F. GOETTEN,
CAROLYN R. JUST,
Attorneys.

JUNE 1959.

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[4] Taxpayer inadvertently states (Pet. 2) that *Baird* v. *Commissioner*, 256 F. 2d 918 (C.A. 7th), certiorari granted, 358 U.S. 918, is in conflict with the decision of the court below. He apparently intended to refer to *Hansen* v. *Commissioner*, 258 F. 2d 585 (C.A. 9th), certiorari granted, 358 U.S. 879.

APPENDIX

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

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(26 U.S.C. 1952 ed., Sec. 22.)

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

(26 U.S.C. 1952 ed., Sec. 41.)

SEC. 42 [as amended by Sec. 114, Revenue Act of 1941, c. 412, 55 Stat. 687]. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

(a) *General Rule.*—The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

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(26 U.S.C. 1952 ed., Sec. 42.)

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